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East Europe Looks Inward for Trade

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EAST EUROPE LOOKS INWARD FOR TRADE

Political developments and economic needs are forcing the East European states to increase economic activity among themselves and with the USSR. The anti-Western aspects of the Soviet-led invasion of Czechoslovakia and the encouragement of increased cooperation among the European Communist countries will advance the trend already under way for increased trade among the members of the Council for Mutual Economic Assistance (CEMA). Although multilateralism under CEMA auspices has been discussed extensively, cumbersome bilateral ties between pairs of East European countries and between individual countries and the USSR will continue to be the major form of their economic relations.

In 1967 East Europe's trade with other Communist countries increased more than its trade with the West, reversing the trend of the past decade. During the previous period most East European countries bought large amounts of free world equipment and technology not available in the Communist world. This practice continues with many of East Europe's purchases in the West financed by credits because East Europe cannot export enough to pay for imports from the West. East European manufactures remain poor in quality and expensive to produce, making many of them unsalable in the West unless substantially discounted. This results in balance of payments problems and periodic shortages of hard currency, especially as repayments of Western credits fall due. The prospects for self-help and mutual aid for industrial development among the East European countries are more likely than extensive aid from the USSR.

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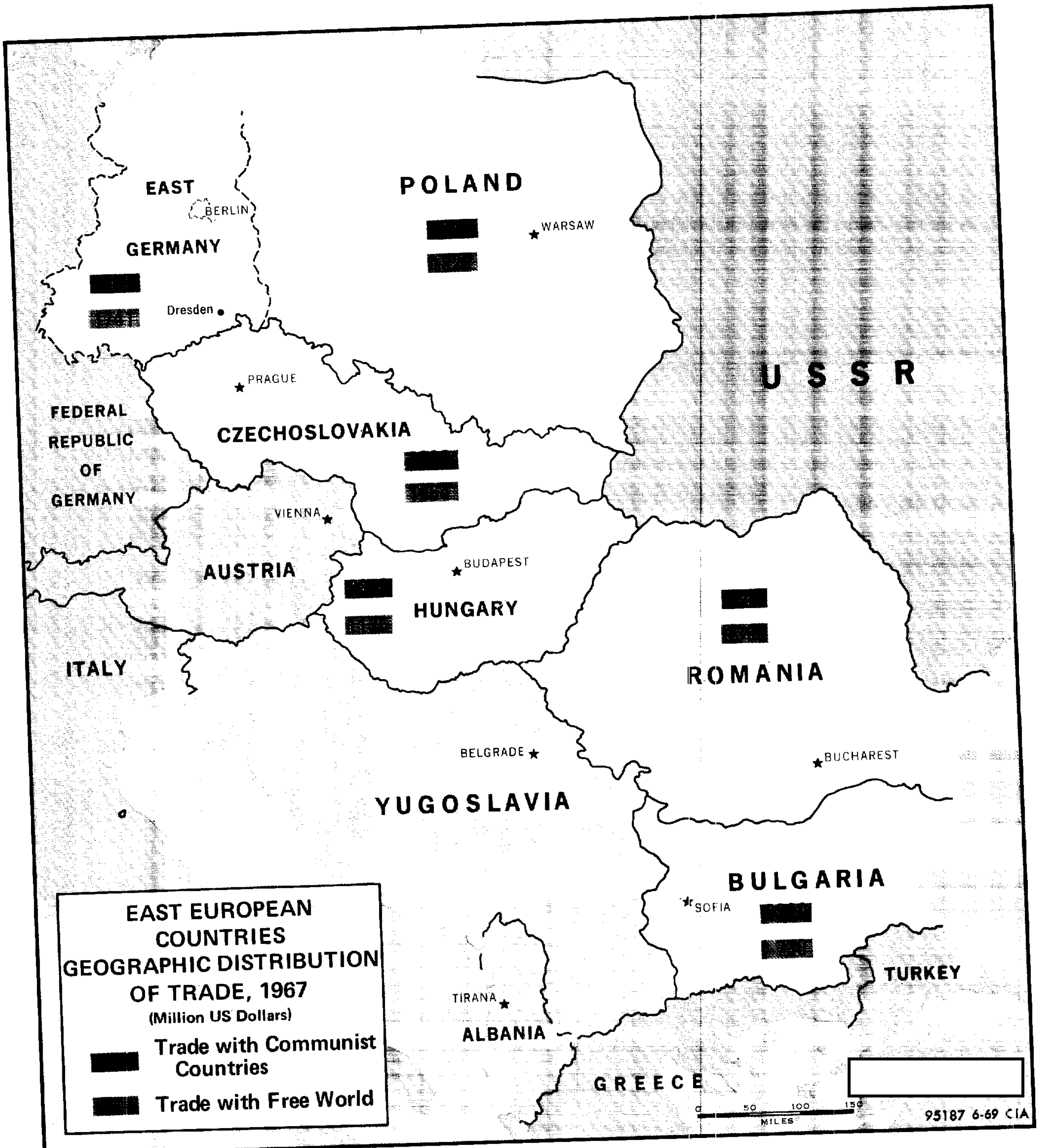
EAST
BERLIN
GERMANY
Dresden
POLAND
WARSAW
USSR
PRAGUE
FEDERAL REPUBLIC OF GERMANY
CZECHOSLOVAKIA
VIENNA
AUSTRIA
BUDAPEST
HUNGARY
ROMANIA
ITALY
BELGRADE
BUCHAREST
YUGOSLAVIA
BULGARIA
SOFIA
TURKEY
TIRANA
ALBANIA
GREECE
EAST EUROPEAN COUNTRIES GEOGRAPHIC DISTRIBUTION OF TRADE, 1967
(Million US Dollars)
Trade with Communist Countries
Trade with Free World
0 50 100 150
MILES
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TRADE WITHIN THE COMMUNIST WORLD

After World War II, the USSR deliberately promoted industrialization in the Stalinist pattern in each of the East European countries. Disregard of rational economic considerations led to the development in these states of relatively small, duplicate plants manufacturing similar products inefficiently and at high cost. This parallel development, with little adaptation to market forces, has resulted in inefficient economies that are competitive, rather than complementary trading partners.

Unless the CEMA framework is substantially reformed, East European trade appears destined to continue along the patterns established in Stalin's time. East Europe can set forth on a new path only through country specialization in production, internal price reform along market lines, and abandonment of bilateral trade balancing in favor of currency convertibility. Until these measures are enacted, the CEMA members will remain their own best markets for each other's manufactures.

The USSR is the primary source of necessary raw materials for Eastern Europe. The Soviet Union is the leading trading partner of all the East European countries, supplying to them most of their ores, metals, and fuel and one third of their import requirements for machinery and equipment. The USSR purchases one half of the East's exports of machinery and equipment as well as large quantities of manufactured consumer goods.

DEPENDENCE ON THE USSR

Although the degree of dependence on the USSR varies markedly from country to country, it tends to parallel the degree of political allegiance paid the Soviet Union by the individual East European countries. Bulgarian trade with the USSR, for example, accounts for over half of Sofia's total trade turnover; Bulgaria is the most closely linked politically to the USSR of all the East European states.

Rumania, at the other end of the spectrum, conducted less than 30 percent of its foreign trade with the USSR in 1967. Unlike most of the other East European countries, Rumania is able to satisfy its domestic food requirements and produce a large surplus of foodstuffs, timber, and petroleum products that are readily marketable in the West. Rumania still depends, however, on Soviet raw materials for its key industries and could not easily supplant this source of supply without drawing down its limited reserve of hard currency.

In recent years, the Soviet Union has shown concern about its trade relations with East Europe. The USSR is obliged to continue its deliveries of raw materials in order to help preserve Communist rule and support the local regimes. But Moscow is nevertheless insistent that these countries, particularly Czechoslovakia and East Germany, import more Soviet machinery and equipment in addition to their imports of Soviet raw materials.

Imports of Important Commodities from the USSR as a Percentage of Total Imports of that Commodity
1966
(Percent)

CEMA Country	Crude Oil	Pig Iron	Iron Ore	Cotton	Coal	Grain
Bulgaria	100	95	84	72	96	--
Czechoslovakia	98	93	82	54	51	99
East Germany	96	80	82	91	63	64
Hungary	85	99	95	49	37	--
Poland	100	96	83	61	100*	75
Rumania	--	100	85	39	51	--

**A small amount of coking coal and anthracite. Poland is a large net exporter of coal to the USSR.*

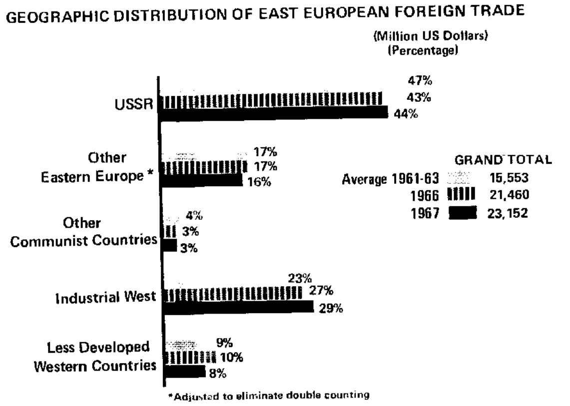
Moscow claims that the high costs of producing raw materials are not compensated for by the prices it receives. It is becoming more selective in the quality of goods it will accept in return, especially in the case of machinery. Moscow also is insisting on price changes in its favor as it is no longer willing to pay West European prices for inferior East European products.

MUTUAL TRADE

The East European states conduct more than one fourth of their trade with each other, but the composition and form of this commerce is unsatisfactory to most of these countries. All rely on exporting manufactured products, most of which are not competitive in Western markets, but they are unhappy with the range and quality of goods available for purchase. Most of these countries sell machinery and equipment and other industrial products as well as commodities indigenous to each country, such as petroleum products in Rumania.

Awareness of the technological progress in the Western world has made most of the East European countries anxious to acquire more advanced and better quality equipment than that available in the East. They must barter mostly with the USSR and their neighbors, however, because they are unable to earn sufficient money through sales in the West to finance the desired purchases. As a result, they are unable to modernize their industrial sectors rapidly so that they are finding it more difficult to increase sales to the West.

GEOGRAPHIC DISTRIBUTION OF EAST EUROPEAN FOREIGN TRADE



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ROLE OF CEMA

The member countries have long felt that the CEMA apparatus could serve as a vehicle for reforming and improving their trade relations, but they differ on how to accomplish this. Recently Hungary has suggested that its internal reforms be adopted by all CEMA countries in order to facilitate trade. Poland has proposed, with Czechoslovak and Hungarian support, that bilateral clearing balances be made convertible as internal price structures are readjusted. Such a step, however, would require reforms of such a scope that it appears highly unlikely to occur. The USSR has refused to consider such a move, probably because it would require Moscow to furnish most of the gold and hard currency needed for settling balances. The Soviet Union instead has pressed for adoption of its own proposal that calls for closer coordination of national plans as a step toward encouraging specialization in production and trade.

Few CEMA proposals, however, have actually been approved, inasmuch as they require unanimous consent from the member states. The International Bank for Economic Cooperation has been established by CEMA to permit the transfer of surplus and deficit accounts among member states on a multilateral basis. Because settlements are made in goods and not cash, however, surplus-account nations are still left with the same array of undesirable items to select from.

Last April CEMA authorized a joint investment bank in which member countries will be

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Soviet and East European Mutual Aid Extensions, 1945-68

(Million US Dollars)

Donor	Recipient	
USSR		
	Bulgaria	1,437
	Czechoslovakia	14
	East Germany	990
	Hungary	348
	Poland	378
	Rumania	123
Czechoslovakia		
	USSR*	900
Poland		
	USSR*	78
Intra-East European Credits		778

**Additional East European credits have been extended to the USSR, but amounts are not available.*

able to pool "transferable rubles." These resources are to be invested in rapidly developing industries and apparently in projects in less developed countries. It is likely to be some time, however, before such a bank is established or operated effectively.

MUTUAL AID

Soviet and East European credits during the past three years have been small except for a sizable Soviet credit to Bulgaria and two large Czechoslovak credits to develop oilfields and natural gas reserves in the USSR. Although Moscow provided some assistance to East Europe during the 1945-55 period, the net flow of capital was to the USSR. The Soviets acquired many billions of dollars of "aid" in the form of war reparations and seized assets as well as through advantageous pricing arrangements. Since 1956 the USSR has committed approximately $3.3 billion in aid to East Europe. Since 1956 Czechoslovakia and Poland have granted credits totaling $978 million to the USSR, and additional credits of unknown amounts have also been extended by other East European countries.

Intra - East European credits have been used recently to a greater extent than heretofore. These credits finance deliveries of machinery and equipment, which eventually will be paid for by shipments of finished products or raw materials produced by the receiving enterprises. In 1958, for example, Czechoslovakia agreed to send machinery and equipment to extract copper from deposits in Poland; Warsaw began to deliver copper to Czechoslovakia this year in repayment for Prague's earlier aid, in accordance with the terms of the agreement.

Cooperation in industrial production also is growing among the East European countries. A joint Bulgarian-Hungarian organization for the design and construction of transportation machinery employs specialists from both countries. Investment funds come from both participants as well as from the organization's profits. East Germany, Hungary and Poland are cooperating in the construction of a new plate glass factory in Czechoslovakia that will produce glass under a British license.

TRADE WITH THE INDUSTRIAL WEST

Although East Europe's total trade turnover grew by 75 percent and trade with other

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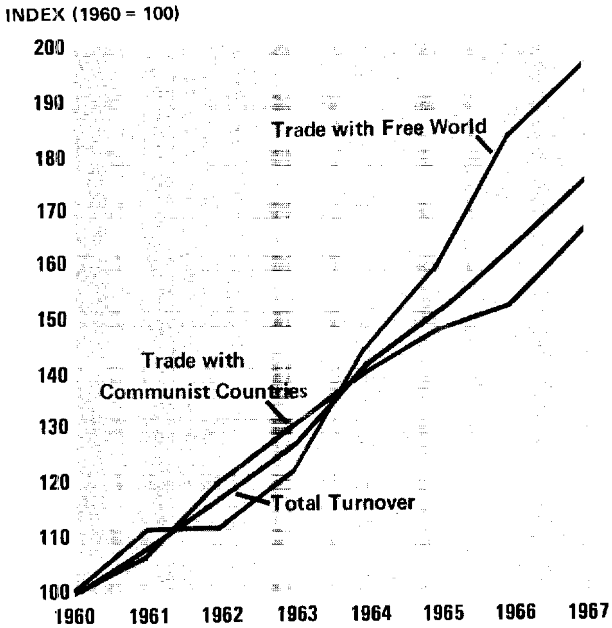
GROWTH OF EAST EUROPEAN TRADE



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Private Guaranteed Credits and Government-to-Government Credits from NATO Countries

(Million US Dollars)

Recipient	Outstanding Credits of over 180 days*	Of Which Outstanding Credits of Over 5 Years
Bulgaria	315.3	104.6
Czechoslovakia	180.5	86.4
East Germany	129.4	19.1
Hungary	119.3	49.8
Poland	585.1	304.7
Rumania	748.5	387.0
TOTAL	2,078.1	951.6

*As of 31 December 1968

Communist countries rose by 66 percent during 1960-67, trade with the free world almost doubled in this same period. Most of the East European states turned to the West for new and better technology, a development that resulted in a substantial increase in imports of investment goods from the West.

Many West European countries, in turn concluded that the East was a promising market for industrial equipment. Credit terms were therefore relaxed, making it easier for East Europe to finance its purchases. Billions of dollars worth of medium and long-term credits have been used in recent years, with outstanding credit now totaling slightly more than $2 billion.

The expansion of East-West trade was financed in large part by East European exports of selected agricultural products and basic manufactures because East European countries have had limited success in developing a large-scale market for machinery and consumer goods. The sale of farm products, moreover, is increasingly restricted by Common Market quotas on imports of such commodities from nonmembers. With the growth of these restrictions, Rumania and Hungary have made overtures toward joining the General Agreement on Tariffs and Trade--Poland and Czechoslovakia already belong--in an effort to improve their competitive trading position.

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The fact that Eastern Europe's imports rose more than exports had resulted in severe shortages of hard currency for most of the countries by the mid-1960s. The rate of increase in imports from the West therefore began to decline, and total trade with the industrial West grew only 7 percent in 1967 or by less than 2 percent if Rumania is excluded. For the first time since 1963 the trade of Czechoslovakia, East Germany and Bulgaria with the industrial West actually declined.

In the mid-1960s many of the East European countries initiated economic reform

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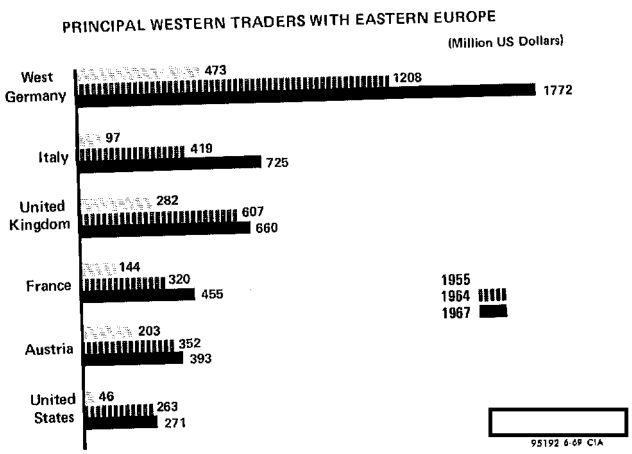

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programs designed to enhance the scope for independent action by individual enterprise managers in both production and commercial transactions. The exposure to Western markets was expected to provide an incentive for improving technology and product quality, and it was hoped that permission to deal directly with Western firms would enable managers to assess world market conditions better. By permitting firms to retain some of their hard currency earnings for either reinvestment or distribution as bonuses, the production of commodities in greater demand abroad was to be further encouraged, according to the reform guidelines.

To date there has been little progress in the direction of meaningful reform, and "economic liberalism" may have been dealt a fatal blow in the aftermath of the invasion of Czechoslovakia. East European manufactures have still not become competitive in world markets, and prospects are poor for any significant improvement.

The leveling-off of trade with the West that began in 1967 is largely the result of balance of payments considerations, because most of the East European countries are reluctant to raise further their indebtedness to Western Europe. Bulgaria, for example, after several years' use of Western credits to purchase industrial plants and technology, has been beset by increasingly serious balance of payments difficulties. As a result Sofia reduced its hard currency purchases by 20 percent annually in 1967 and 1968.

Last year Rumania also registered an actual decline in the level of its trade with the West, after almost quadrupling that trade during the 1960-67 period. Like many of the other East European countries, Rumania began to feel the hard currency pinch; a serious drought also reduced Bucharest's ability to export agricultural products.

PROSPECTS IN THE WEST

Trade with the West is expected to grow more slowly during the next few years than it has during the last decade. The East European nations will be unable to reduce their dependence on the USSR for raw materials because they will have to rely on the Soviets as a market for their finished goods. East European manufacturers will not be competitive in Western markets unless they substantially improve product quality. Major changes must also be made in economic management, and specialization in production among CEMA members must increase greatly.

Western traders are nevertheless expected to continue experimenting with various ways to increase their business with Eastern Europe. East European interest in such arrangements—largely joint production ventures—centers on the possibility of attracting Western capital in a way that is politically acceptable. They also hope that some of these joint arrangements will ease the entry of their goods into Western markets.

Several joint projects are located in the industrial West but at least 30 have been started in less developed countries. In general, those in the

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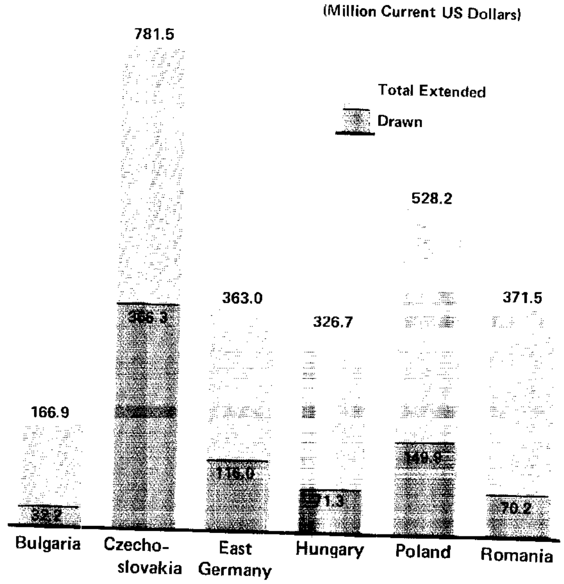
EAST EUROPEAN CREDITS AND GRANTS TO LESS DEVELOPED WESTERN COUNTRIES, 1954-1968
(Million Current US Dollars)



TOTAL EXTENDED 2,537.8
TOTAL DRAWN 805.9

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industrial West tend to be small trading companies, whereas those in less developed countries are concentrated in the development of raw materials.

Few joint enterprises have been located in Communist countries, largely because of ownership problems. Only two manufacturing concerns are known to exist: a Polish - West German firm manufacturing tape recorders and a Polish-Swedish furniture manufacturing company. Three joint hotel operations involve the United States.

Simpler forms of East-West economic cooperation also have been beneficial to the Eastern participants. They include licensing, the provision of contractual services, and various types of collaboration in production or sales that do not involve equity capital in a new enterprise.

TRADE WITH LESS DEVELOPED COUNTRIES

East Europe's trade with the less developed countries (LDCs) increased gradually during the period 1961-66 and is slightly greater than Soviet trade with them. More than half of this trade is with the Near East and South Asia.

East Europe has generally managed to sell more than it has purchased from the LDCs and has continued to maintain a favorable over-all balance of trade with these countries. Machinery and equipment not easily salable to industrialized countries is frequently acceptable to the LDCs, especially when credit or barter is involved.

The extension of economic credits and technical assistance has helped maintain East Europe's gradual growth in trade with the LDCs. In general, East Europe provides industrial plants and equipment and is repaid in tropical products and raw materials.

East European economic aid has less apparent political motivation than the USSR's; on that basis East European assistance often is more acceptable by LDCs establishing their first economic ties with the Communist world. Czechoslovakia continues to be the leader in extending such aid, but significant amounts have also been supplied by Poland.

East European Economic Aid Extensions to Less Developed Western Countries

(Million US Dollars)

1954-68	1967	1968
2,538	181	171

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East European efforts to diversify and augment their sources of oil account for much of their recent aid activity in the LDCs. Recent economic agreements between Iran and Czechoslovakia, Hungary and Rumania call for most repayments to be made by delivery of Iranian crude in return for machinery and other capital goods. Iranian shipments of oil, however, have been impeded in part by increased transport costs caused by the closure of the Suez Canal in 1967.

East Europe also provides technical assistance in the LDCs and trains students and technicians from these areas. In 1968 there were an estimated 7,250 East European nonmilitary technicians in these countries with almost 4,000 academic students and 700 technical trainees receiving instruction in Eastern European institutions. [redacted] 25X1

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